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MEASURES FOR EFFECTIVE MOBILIZATION OF DOMESTIC RESOURCES IN AFRICAN LEAST DEVELOPED COUNTRIES

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S U M M A R Y

1. This paper presents, on a preliminary basis, an assessment of the problems of mobilizing savings in the African least developed countries (LDCs), proposals for increasing the mobilization of domestic resources and their optimum allocation for the implementation of the Substantial New Programme of Action (SNPA).

2. An examination of the plans of African LDCs indicates that the majority of the countries have neither indicated specific elements of strategy for the mobilization of domestic savings nor allocated adequate budgetary resources to finance the portfolio of development projects and programmes. The result is that dependence on external sources of finance continues to feature heavily in the plans of the majority of African LDCs, this dependence being as high as 100 per cent for at least three countries and 80 per cent for at least seven countries. Only four countries envisage financing the bulk of their development expenditures from domestic sources.

3. There are three main reasons for continued heavy reliance on external sources:

(a) Inability to raise adequate revenues because of the low per capita income of the population in general, and institutional weaknesses in the machinery of tax collection;

(b) Misallocation of public resources between capital and recurrent budgets, the latter being exacerbated by the high cost of government undertakings, including bureaucratic overstaffing, defence expenditures and the provision of services, such as health, education, utilities, etc. for which little or no user charges are imposed;

(c) Substantial operating losses by state enterprises and consequent drains on the treasury, and subsidies of various kinds.

4. There has been a growing awareness that the continuing adverse international economic situation over the past few years has dimmed prospects for the continuation of external financial assistance at anywhere near past levels. In the light of this situation, Governments of African LDCs will have to consider in earnest resorting to domestic resources to finance their portfolio of projects and programmes.

5. African LDCs need to review their current fiscal and monetary policies by way of responding positively to the difficulties imposed by the international economic environment. They should make strenuous efforts to mobilize additional domestic resources, since an increase in domestic savings is essential and indispensable if plans are to materialize. The primary and immediate source of revenue to meet the objective of realising their saving potential remains taxation. The compulsory nature of taxation should offer the greatest scope for increasing revenue. A few specific areas for general policy consideration suggested in this paper include, in addition to a review of the indirect tax and tariff structures with the aim of increasing tax revenue from these sources, the introduction of taxes on unearned incomes in the form of wealth or property taxes, capital gains taxes, gift taxes, estate and inheritance duties that either do not exist or are insignificant as a proportion of tax revenue. The immediate introduction of sales and excise taxes on such services as hotels, restaurants, banking, insurance and construction - taxes that either are non-existent or yield only modest revenues - should constitute an additional source of revenue. The use of agricultural taxation to siphon off the "agricultural surplus" for higher rates of capital formation has also been suggested.

6. Forced savings charged on incomes in the form of education tax, health tax and State pension schemes into which wage and salary earners may pay a portion of their incomes with matching contributions by employers could be considered as inevitable measures of economic policy for African LDCs.

7. A tax structure of a highly progressive nature is recommended not only to enhance the effect of taxation but also to ensure a more equitable distribution of income that, in itself, could result in additional savings. The propensity to save among the upper income groups is low in least developed countries and equitable income distribution should enhance the scope for increasing the rate of saving.

8. The creation of an efficient tax administration and equitable tax systems in which both direct and indirect taxes should play their proper role, as well as the initiation of radical tax reforms, should be considered as an integral part of effective resource mobilization.

9. In addition to tax sources which play a dominant role in increasing revenues, non-tax sources of income, such as increased fees for government services in the form, particularly, of public utilities and the elimination of subsidies should be given special consideration.

10. A well designed borrowing programme, facilitiated by issuing government securities in smaller denominations and making them readily available to the public through appropriate financial institutions, with interest rates higher than in commercial loan markets, should result in increased revenue, modest though these steps may be.

11. Improving the efficiency of State enterprises and their capacity utilization should result in higher volumes of production and increase revenues. Limited and cautious monetary expansion in some countries enjoying budget surpluses may also be considered advantageous for overcoming certain structural problems and as a residual source of non-tax revenue.

12. Yet another broad area of priority attention for bringing latent resources into active use is the vast pool of underemployed and unemployed labour. Resources must be mobilized on a large scale to satisfy infrastructural needs such as roads, water works and bridges and services such as schools, clinics, housing and related services. Efforts must be made by African LDCs to mobilize unproductive and underutilized labour in rural and urban areas following the example of Rwanda and Ethiopia which have made a successful start in this direction. Co-operative self-help and self-financing schemes should be promoted and credit facilities should be made available to supplement and encourage such efforts.

13. Attention may be drawn to the need for formulating appropriate incomes and pricing policies for the generation of additional revenue for development, particularly in countries where the State sector predominates. Among these policies should feature the need for narrowing salary and wage differentials between country and town (the public sector in particular), for in some African LDCs studies show that the ratio of public sector wages to the income of a peasant is 20:1.

14. Countries with significant numbers of workers beyond their borders should not simply use of official exchange rates but should offer attractive rates to increase the flow of repatriated earnings. On the other hand, luxury imports should be eliminated altogether or penalized by prohibitively high tariffs.

15. Efforts to increase revenue to finance development should be capped by a programme of austerity with efficient use and strict control of budgetary expenditure, particularly recurrent expenditure, to eliminate internal leakages in the form of wasteful expenditure. Radical measures should also be taken to minimize the volume of external financial leakages arising from illegal activities in international trade such as over- and under-invoicing of imports and exports which result in the outflow of substantial resources from African LDCs.

16. An increase in domestic resources for the attainment of maximum growth is the responsibility of Governments to a very large extent, but the public sector can do only part of the job. It is of paramount importance, therefore, that the conditions and instruments for the mobilization of additional resources for promoting voluntary private saving (households, small businesses and communities) should be created, with particular emphasis given to the large subsistence sector. The development of financial institutions in the form, inter alia, of savings banks, commercial banks, pension offices and insurance companies should help in bringing about both a higher saving rate and a better utilization of the flow of resources.

17. The subsistence sector, in particular, where the majority of the population and resources are to be found, would have no other opportunity of saving in the absence of these institutions than private accumulation in the form of unproductive investment in kind (houses, livestock, etc.). If the subsistence sector could be reached by simple financial institutions, substantial resources which would otherwise have been idle or used for non-development investment or consumption could ensure greater tax revenue.

18. To bring those who save and those who would want to borrow and invest under the financial market, financial institutions should be strengthened and stretched, so that they may mobilize cash surpluses of farmers, communities and small businesses and the population in general. These institutions do exist in African LDCs to varying degrees, but they would need to be strengthened with a dense-network of branches.

19. It will be necessary to organize these institutions in such a way that they not only influence the quantity of money, but also allocate savings more efficiently to productive investments. Private savings are hampered not only by inadequate distribution of financial institutions, but also by unattractive returns on deposits, real rates of return being eroded by high rates of inflation. The state of the banking institution should, therefore, be such that interest rates on deposits are continuously adjusted and rates exceeding the rate of inflation are offered, the absence of which could, among other things, be considered responsible for a decline in private savings over the past years in a number of African LDCs.

20. The establishment and strengthening of other basic development institutions and infrastructure for an optimum allocation of resources which has a close bearing on rates of saving must include the government machinery itself. There is a need to strengthen

the government machinery for formulating plans, improving methods of economic management, monitoring the implementation of policies, projects and programmes and for providing effective guidance to the private sector in the attainment of goals and objectives of national plans.

21. Investment priorities should be rationalized and Governments should organise the machinery for the preparation and appraisal of projects for optimum use of resources. The import content of investment plans should be minimized, since large external resources are the result, at least in part, of high import co-efficients of development projects and programmes. Countries should develop and strengthen institutions for the selection, unpackaging, adaptation and transfer of appropriate technology entailing labour-intensive, low-level techniques of production and with an optimum input of indigenous technology.

22. Appropriate legislation to rationalize the transfer of technology and prevent an outward drain of resources, including a review, and re-enactment, where necessary, of investment legislation with excessive tax concessions to multinational corporations resulting in considerable losses of resources, should be formulated and enacted.

23. Support from the international community in the form of technical assistance could be utilized more effectively for developing and strengthening institutional infrastructure, including tax administration and collection, management-training institutes, project preparation and appraisal and technology transfer centres.

I. INTRODUCTION

A. Background

24. The purpose of this paper is to examine the problems and identify the various sources of domestic resource mobilization in African least developed countries (LDCs) to finance the implementation of plans within the framework of the Substantial New Programme of Action (SNPA). The 26 African countries identified by the United Nations as least developed are: Benin, Botswana, Burundi, Cape Verde, The Central African Republic, Chad, The Comoros, Djibouti, Equatorial Guinea, Ethiopia, The Gambia, Guinea, Guinea-Bissau, Lesotho, Malawi, Mali, The Niger, Rwanda, Sao Tome and Principe, Sierra Leone, Somalia, The Sudan, Togo, Uganda, The United Republic of Tanzania, and the Upper Volta. Numerically, they represent two thirds of all LDCs.

25. The term "least developed" disguises the existence of extensive heterogeneity among African LDCs. Indeed, African LDCs represent a composite of striking contrasts, both economic and non-economic. In terms of population, they include, on the one hand, Cape Verde with only 300,000 people; at the other end of the scale are countries like Ethiopia with 32 million people representing more than one fifth of the total population of 140 million.

26. In terms of land surface, they range from the tiny Comoros (2,200 sq Km) to the giant Sudan (2,506,000 sq Km -- by far the largest amongst all LDCs). Among them are countries rich in real resource potential: agriculture, livestock, fisheries, forestry, tourism, hydroelectricity and minerals. Other suffer from topographic and climatic handicaps. There are the land-locked countries, such as Botswana, Burundi, Chad, Lesotho, Mali, Rwanda and Uganda, some suffering from severe geographic disadvantages; and there are islands, such as Cape Verde and the Comoros. Almost all (see map) are concentrated in the northern half of the continent, forming a belt, as it were, from east to west.

27. Many African LDCs have been independent only since the early 1960s. They differ in political philosophies, ranging from those that seem to have firmly embraced the principles of laissez-faire capitalism to those that profess varieties of socialist ideology. These differences in ideology are significant, in that they have considerable influence on policies in the mobilization of resources. For example, countries with a socialist ideology must rely more heavily on surpluses of State-run enterprises, as well as on the manipulation of costs and prices; those with capitalist ideology would need to rely more heavily on taxes and levies of various kinds.

. There are, nevertheless, similarities (and complementarities) among African
Cs. The economies of most African LDCs are dominated by agriculture which, to a
ry large extent, is non-monetized; the modern, or market, sector is, by contrast,
small fraction of the total economy. Average per capita annual growth in agricultural
oduction was negative in 11 of the African LDCs during 1980-1981. Manufacturing
lue added per capita grew at an average rate of only 0.4 per cent during the decade
70-1980 (with negative rates for 1971, 1974, 1976 and 1980) as against an average of
5 per cent in other developing countries. The very low growth of their economies is
e result of scarcities of domestic resources, low levels of incomes and low savings,
ainst the background of which all are caught in the grip of a low-income, low-savings,
-growth trap.

. Another similarity, notable for its economic impact in terms of the volume of
mand for goods and pointing to the need for collective endeavours is the size of popu-
tion. Over 50 per cent of African LDCs have fewer than 5 million people. Among
ese, five countries: Botswana, Cape Verde, The Comoros, The Gambia and Guinea-Bissau
ve populations of less than a million each.

. African LDCs face an enormous challenge during the 1980s and beyond, not only in
e mobilization of domestic resources to break out of a low-growth trap and achieve
velopment targets put forward in their respective plans for economic and social deve-
pment, but also in organizing those resources and in managing them more efficiently.
is challenge must be taken with the utmost seriousness.

B. Approach

. The primary objective of this paper is to furnish, to the extent possible, a
nceptual framework for the formulation of a range of policies for the mobilization of
mestic resources and their efficient utilization - a subject indeed at the very heart
economic and social development. While the paper will deal with problems which many
rican LDCs have in common, different countries have their own specific characteristics
ich are beyond a general discussion such as this.

. This paper is not, therefore, an analysis of the problems of resource mobilization
any one country. Such an analysis would require a thorough examination and a clearer
rception of the resource base as related to optimum choices of investment of each
rican LDC, and in keeping with their different characteristics. The quantum of addi-
onal resources available in each African LDC can be known only after such a study.
it succeeds in setting the stage for such in-depth investigations, the paper will have
rved its purpose.

II. PROBLEMS OF DOMESTIC RESOURCE MOBILIZATION: GENERAL CONSIDERATION

A. Definitional questions

33. Before beginning to consider the problems and sources of domestic resource mobilization, it would be well to define, for the purpose of this paper, what is meant by the term "mobilization of domestic resources". The term "domestic resource mobilization" refers to a process whereby national resources are made available for investment and capital formation. The term refers not only to a situation in which resources hitherto inactive are activated for the purpose of attaining desirable rates of economic development, but also - and equally important - the prevention of a state of underutilization as well as misallocation and inefficient utilization of resources.

34. The need for domestic resource mobilization arises directly out of the need for investment and capital formation at progressively higher levels. The mobilization of resources determines, in the main, the process of capital formation, and until sufficient resources are mobilized by cutting down on immediate consumption, the objectives of attaining rapid economic development cannot be attained. Savings are, therefore, of paramount importance for attaining desired rates of growth.

35. Economic theory has much to say concerning the process and problems of domestic resources mobilization. Several economists (among them W.A. Lewis and W.W. Rostow) specify a rise in the rate of productive investment to upwards of 10 per cent of national income as a necessary requisite for the economy to "take off". Writing almost three decades ago, W. Arthur Lewis, a noted economist, pointed out the central problem in the theory of economic development as being a "... process by which a community which was previously saving 4 or 5 per cent of its national income or less, converts itself into an economy where voluntary saving is running at about 12 to 15 per cent of national income or more". 1/

1/ W. Arthur Lewis, Economic development with unlimited supplies of labour(1954).

36. Savings of, say, 5 per cent and less of gross domestic product (GDP) will normally result in little or no economic growth in countries experiencing high rates of population growth, as is the case with African LDCs. This is because the percentage of GDP that must be invested to keep abreast of the work force must be correspondingly higher. If there is to be any development, therefore, there must be a significant increase in the ratio of saving to GDP. In African LDCs, and in all developing countries in general, private saving institutions in the form of banks, insurance, corporations, etc. are either inadequate or unable to mobilize domestic savings and there is very little private savings to speak of. It is, therefore, the responsibility of Governments to use fiscal and monetary policies to mobilize savings. The bulk of savings must thus come from the public sector.

B. The nature of the problem

32. In African LDCs, as indeed in many other developing countries, the inadequacy of domestic resources stands out as a cripping obstacle to development efforts. Domestic savings have rarely exceeded 10 per cent of GDP and are oscillating at a low equilibrium level 2/ in several African LDCs. The general state of wars, civil strife, persistent drought, inflationary pressures and increasing government consumption have, among other things, resulted in declining savings. Unless resolute measures are taken to alter the situation, savings will tend to remain at this low level. This situation compares unfavourably with experience elsewhere in developing countries. In recent years, savings have varied, for example, from 22 per cent of GDP in countries such as Thailand to 33 per cent in Taiwan. This level of savings is higher than the saving rate in South American countries, and can only be considered as phenomenal when compared with those in African LDCs. The problem of low savings in African LDCs falls into three main categories: low incomes,. high government expenditure and the structural deficiencies in the economies of African LDCs that constrain the ability of Governments to raise revenues necessary to fund expenditure.

38. The extremely low level of per capita income in African LDCs with the bulk of the population far below minimum standards of living and in subsistence sectors is the principal reason for low savings. But there are several other reasons why savings continue to remain at extremely low levels. These include administrative and defence expenditures, government enterprises and subsidies of various kinds. There have been

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2/ Savings in one African LDC recorded a decrease from around 10 per cent of GNP in 1973 to 0.7 per cent of GNP in 1979.

persistent and significant increases in the volume of government consumption over the years as reflected in trends in budgetary recurrent expenditures. The largest components are taken up by the wages and salaries of government personnel and those of the military defence establishments. The growth of government spending on public administration and defence averaged about 8 per cent in eight African LDCs between 1970 and 79, an average which was much higher than the growth recorded in national output during the period.

39. In one African LDC, budgetary recurrent expenditure in one year reached a level of 99 per cent of total revenue; deficit financing in the same year reached a level of almost 6 per cent of GNP, financed mainly through internal bank borrowing. Such a rapid increase in the level of recurrent expenditure obviously draws resources away from savings and productive investment, and is a matter for examination by the Governments of African LDCs.

40. Subsidies of various kinds, direct and indirect, to State-run enterprises as well as for production and consumption common to a number of African LDCs also utilize resources which would otherwise result in increase in savings and capital accumulation.

41. The prevailing tax regime, itself the result of structural deficiencies in the economies of African LDCs, severely limits the realization of the savings potential. Typically, agriculture contributes over 50 per cent of GDP and the economies of African LDCs are dominated by large subsistence sectors where the bulk of total GDP is produced and consumed. As a result, very little tax is collected from this sector and the existing tax base is not only extremely narrow but is also relatively inelastic. The problem is compounded by the prevailing deficiencies in the machinery of tax collection in almost all African LDCs.

42. With the low level of savings, financing of development programmes in African LDCs is heavily dependent on the inflow of foreign capital. The development strategy for 1980s of African LDCs places heavy emphasis on external finance to meet what can only be considered as overambitious growth rates of higher than 6 per cent during the decade for most countries. Aid requirements of African LDCs for the first half of the decade (1981-1985) total approximately $38 billion, 3/ averaging $7.6 billion per annum, and 30 billion for the second half of the decade (1986-1990). The figure of $7.6 billion compares with actual external financial flows of approximately $4 billion in 1979, and represents an 85 per cent increase in external financing requirements over 1979.

3/ Estimated in constant 1980 United States dollars.

43. At least three 4/ of the 25 African LDCs seem to have shifted the entire burden of their total development expenditures to donors during the first half of the decade. Another seven 5/ countries have over 80 per cent of total development expenditure earmarked for financing from external sources during the period 1981-1985. Only four 6/ countries expect over 50 per cent of the total development expenditure to be financed from domestic sources.

44. External funding is required to meet not only the foreign exchange cost of projects and programmes but also recurrent costs, either at the project or budget level. External funds requested to cover local cost financing make up close to 20 per cent of the total public expenditure in one African LDC that is asking donors "... to pick up as large a portion of local costs as possible...". African LDCs are facing such budget stringency that they find it increasingly difficult to finance local and recurrent costs of projects and programmes, and are being forced to resort to the unhappy choice of shifting the very scarce external resources away from productive projects and programmes in favour of recurrent costs. Recourse to requests for recurrent cost financing on the part of African LDCs, which has now become common, can only be considered as leading to a rather dangerous situation of open-ended dependence rather than self-reliance with diminishing interest in and commitment to development.

45. Recurrent cost problems as well as the general problems of public sector activities are, to a large extent, prima facie evidence of inappropriate government policies, faulty decisions and misallocation of resources. This is particularly the case with productive projects which should not, if designed properly, be a drain on the economy. Any investment in productive projects is undertaken in expectation of a stream of costs and benefits. The expected stream of benefits, if projects are properly designed and executed, should generally be sufficient to cover the recurrent costs of projects, as well as result in surpluses for further investment. The appropriate procedure is to perform economic, financial and technical analyses of projects before their approval and implementation.

4/ The Central African Republic, Comoros and the Upper Volta.
5/ Benin, Burundi, Cape Verde, the Gambia, Mali, Rwanda and the United Republic of Tanzania.
6/ Botswana, Guinea, the Sudan and Uganda.

46. Dependence on external aid is such that the plans of African LDCs may be considered as aid-dominated and the strategy aid-oriented. Such overwhelming reliance on external sources not only makes a mockery of the efforts of African LDCs to initiate development, but also swells the volume of external assistance beyond all reasonable proportions. It also raises doubts about the sincerity of African LDCs in becoming more committed and in shouldering greater responsibilities for the success of their development programmes. Dependence on external sources can only render implementation of the programmes of African LDCs extremely difficult, if not altogether impossible. This is because the continuing (if not worsening) adverse international economic situation dims any prospects of increased aid flows.

C. Dependence versus self-reliance

47. The United Nations Conference on LDCs adopted, in Paris, the SNPA for the transformation of the economies of the LDCs with the objective that "... the least developed countries will be required to mobilize domestic financial resources in addition to international support. They would consider measures which would facilitate efforts aiming at the level of their domestic savings rate" 7/. Thus, the SNPA indicates, in clear terms, that the major responsibility for the mobilization of resources for the implementation of country programmes rests, first and foremost, on the shoulders of the LDCs themselves. Therefore, the mobilization of increasingly higher volumes of domestic resources for economic and social development should be a major area of concern for African LDCs in the decade of 1980s.

48. Indeed, with the continuing deterioration in the international economic situation, the need for relaience on domestic sources for financing the bulk of development expenditures and for establishing the economies of individual African LDCs on the path of ultimate self-reliance has never been as crucial as it is during the decade of 1980s. Indeed, this may be a desirable strategy in view of the increasingly large numbers of developing countries 8/ whose economies are on the verge of chaos beneath a massive pile of international debt. Foreign aid, short of grants, is less desirable on account of the long-run liabilities that it imposes on the recipient country; it is like accepting a rope now, the better to be hanged later.

7/ The Substantial New Programme of Action for the 1980s for the Least Developed Countries, Paris, September 1981, A/CONF.104/22, page 7.

8/ E.g. Argentina, Brazil, Mexico and the Republic of Korea.

49. The mobilization of adequate internal financial resources should thus pose a serious challenge for the Governments of African LDCs for the implementation of investment projects and programmes in the 1980s. The need for strengthening the domestic savings effort should increasingly assume greater and wider significance. Increased mobilization of domestic resources will also ensure a more effective use of available external resources, because inadequate domestic resources adversely affect the disbursement of external resources to a point where some African LDCs are faced with a difficult and anomalous situation where available resources (foreign) cannot be utilized because matching resources (local) are not available.

50. The strategy for financing development programmes should, therefore, be reversed and the primary responsibility for financing development programmes should be borne by the Governments of African LDCs themselves. External resources should be considered only as supplementary to domestic saving efforts.

51. Several objective conditions dictate the need to finance the plans of African LDCs through mobilizing domestic resources and to evolve a more self-reliance strategy of development.

(a) In 1981, the largest donor, the United States, cut its aid from 0.27 per cent of its GNP to 0.20 per cent. Other donors, including Australia, New Zealand, Norway and Japan, have similarly reduced their aid programmes. The recent substantial cut of up to 45 per cent in the UNDP budget for the 1982-1986 country programming cycle could be considered as a reflection of such reductions as well as exchange rate fluctuations;

(b) Countries of the European Economic Community, among the largest donors as a group, are unlikely to make significant resources available before the signing in 1985 of the new convention with African, Caribbean and Pacific countries. All African LDCs are signatories to the Lomé Convention;

(c) Nordic countries seem to have reached just about the limit, providing, as they do, the highest concessional assistance in terms of GNP;

(d) The meeting of multilateral and bilateral financial and technical assistance institutions with representatives of the LDCs held in Geneva in October 1982 to assess, among other things, the assistance requirements of LDCs also left no room for any optimism.

52. African LDCs are thus left with no choice but to adopt an attitude of increasing self-reliance in the decades ahead. This is indeed desirable not only in terms of putting one's house in order first, but also of putting into practice the concept of individual and collective self-reliance - a concept that has never been elevated beyond the level of a slogan. Certainly, a state of total and helpless dependence on external aid must be reversed in favour of greater national responsibilities, commitments and efforts for economic and social development.

53. The Governments of African LDCs would, therefore, have to consider:

(a) The need to formulate alternative scenarios of development strategies and adjust growth targets and objectives to the objective possibilities of achieving them;

(b) Immediately setting about mobilising additional domestic resources for the implementation of their revised plans. There is no secret as to the wherewithal for additional domestic resource mobilisation and for raising the level of savings to 12 to 15 per cent of national income. African LDCs must tighten their belts ever more and prepare themselves for greater sacrifices.

III. MOBILIZATION OF DOMESTIC RESOURCES

54. Against the background of the general problems of resource mobilization, the basic questions arise of available sources and modes for mobilizing the necessary domestic resources. The discussions in this section of the paper are too general. They only indicate various ways and sources of mobilising domestic resources and should place in proper perspective the need for follow-up studies on the particular conditions of individual African LDCs.

55. What sources and instruments are available to African LDCs to raise additional revenue to finance their development programmes? The question is easy to answer conceptually and will be considered under the broad headings of: taxation; use of profits of State enterprises; Public borrowing deficit financing and absorption of unproductive labour into productive work. In addition, the need to establish, or strengthen, the institutional machinery for channeling savings into productive investment and for efficiently allocating available resources will be highlighted, in line with the definition given of the term "domestic resource mobilization".

A. Sources and modes

1. Taxation

56. Taxation is the most important fiscal tool in the hands of Governments for mobilizing funds from domestic sources. Of the various sources from which the necessary savings can be mobilized for public expenditure, taxes constitute the largest share of revenue in African LDCs. Tax revenues typically account for over 70 per cent of total public revenue. For some countries this ratio goes as high as 85 per cent. Within tax revenue, indirect taxes, including customs duties, sales taxes and excise duties, remain the principal source of revenue. An examination of the pattern of taxation shows that direct taxes are of little importance in most of the countries. Although some African LDCs have high marginal rates of tax on incomes and profits, these do not appear to result in high tax revenues because of evasions and the low tax base in general.

57. Of the indirect taxes, sales and excise taxes on such services as hotels, restaurants, transport, banking, insurance, construction and others which normally account for much of the value added created outside agriculture would need to be heavier. In some countries (e.g. Malawi and the Niger) sales taxes contribute over 20 per cent of total tax revenues; in many others, they generate only modest revenues and are yet to be introduced in some countries (the Gambia, Somalia and the Sudan). Additional taxes on petroleum, tobacco, alcohol, beer and luxuries in general should constitute additional sources of revenue.

58. Excise taxes on fuel for motor vehicles together with motor vehicle licence fees are said to be much lower than they are, for example, in the developed countries of Western Europe; these could be considered as offering an expanding tax base, in addition to being considered as a component of energy policy. Other possible areas of additional taxation could result from a restructuring of import tariffs, of sales taxes and excise duties, rationalization of tax concessions to industry, of agricultural taxation and taxes on public services as well as improvements in tax administration and collection in general. Forced savings charged on incomes in the form of education tax, health tax, etc. and expedient measures such as the introduction of State lotteries and elimination of subsidies on consumption except food items consumed by low-income groups, are justifiable measures of economic policy for mobilizing domestic revenue.

59. The reliance on indirect taxes by most African LDCs is the result of the predominance of the subsistence sector and problems relating to the machinery of tax administration. Tax structures prevailing in African LDCs are such that a disproportionately heavy burden of the tax falls on the rather small, market sector of the economy as a result of which the volume of tax revenues continue to remain small. In several African LDCs the ratio of tax revenue to the national product is less than 15 per cent of GDP as compared to other developing and developed countries for which, according to studies, the ratio is as high as 30 per cent. This indicates that there exists untapped tax potential and that additional revenues to finance development programmes can be generated through the introduction of new tax measures. African LDCs would need to evolve effective, as well as workable, systems of taxes with equal emphasis on direct taxes so as to mobilize more domestic funds for development. Existing tax structures would not result in any significant mobilization of additional resources.

60. The question of which sources and taxes are the most appropriate for mobilizing maximum revenue can be answered only in the light of the conditions obtaining in African LDCs, the main consideration being the structure of their economies. Agriculture remains the foundation of the economies of African LDCs, most of which are endowed with productive resources (including vast livestock populations) which present real possibilities for development if utilized optimally. The exploitation of natural and human resources historically provided the real premises of a country's social and economic development. That a number of African LDCs are rich in natural and human resources, in addition to being located geographically close to one another creates favourable conditions for the development of these vast resources. The resources of unutilized arable land, estimated at over 90 per cent in a number of African LDCs, as well as of labour, can only be considered as vast reservoirs determining the mobilization of resources. Against these real resources, the financial resources to be tapped from the monetized sector can only be considered a mere pittance.

61. Indeed, in many countries, developed and developing, agricultural taxes were used as a means of bringing about rapid economic development. Unless the agricultural sector is taxed properly to tap the "agricultural surplus" of the economy the desired volume of savings will not be achieved and, in the particular circumstances of some African LDCs, taxes on agriculture should serve the objective of resource mobilization. Officially, the share of agriculture in GDP is between 30 and 60 per cent and agricultural output is the single most important determinant of overall economic growth as well as of funds for generating investible surpluses. The resource base in African LDCs is agriculture and mobilization of resources for the generation of savings and investment can have a broader base only if agriculture is brought fully into the picture.

62. Many economists stress the significance of progressive taxation, direct and indirect, as an instrument for the mobilization of additional domestic resources. Therefore, in order to make the effect of taxation on domestic resource mobilization more prominent, tax rates should be structured in such a manner that they are highly progressive. Such taxes should be particularly heavy on unearned incomes such as wealth or property, capital gains, gifts, estates, inheritances, etc., to reduce not only the consumption expenditure of high-income groups but also the degree of social inequality. These forms of taxation either do not exist or are insignificant in almost all African LDCs, although some of these taxes (e.g. inheritance) were known and collected in ancient Rome, Egypt and several European countries. Luxury imports should either be eliminated altogether or be penalized by prohibitvely high import tariffs.

63. Economic and social development plans involving high rates of growth and higher levels of investment must be accompanied by proper taxation policy - the missing link in the plans of African LDCs. It is important that the scope and structure of various types of taxes should be studied in each African LDC, not only to broaden the tax base but also to formulate appropriate tax policies. Commissions on taxation and tariffs should be created to examine types of additional taxes, to review tax structure periodically and to formulate taxation policies in each African LDC. The formulation of a proper taxation policy should involve stimulation of existing production capacities and creation of new ones for a much fuller exploitation of existing potential and the tax system should be incorporated in the process of the production of material goods and services.

64. It must be noted that a suitable national environment should be created to enlist the full support of the entire population. This would require the creation of a proper economic, social, moral and political climate in which the population, as a whole, would have full confidence in the Government. For more successful results, measures must be taken to convince the population of the necessity and inevitability of higher taxes and sacrifices.

65. At the same time, Governments of African LDCs must increase their ability to raise and collect taxes and should initiate and support the development of the appropriate institutional machinery for the administration of taxes in order to improve their tax performance. Technical assistance could be used effectively to improve the administration of taxes.

Table 1

Total development expenditure, domestic financing and aid requirements, 1981-1985

Country	Total development expenditure (in million of US dollars)	Distribution	
		Domestic financing (in percentage)	External aid required (in percentage)
Benin	1 758	18.0	82.0
Botswana	1 928	86.6	13.4
Burundi	1 194	17.1	82.9
Cape Verde	397	13.1	86.9
Central African Republic	971	-	100.0
Chad	-	-	-
Comoros	240	-	100.0
Ethiopia	7 000 a/	47.1	52.9
Gambia	395	91.2	8.8
Guinea	1 639	57.9	42.1
Guinea Bissau	-	-	-
Lesotho	-	-	-
Malawi	-	-	-
Mali	2 740 a/	2.6	97.4
Niger	2 792	43.0	57.0
Rwanda		9.1	90.9
Somalia	1 989	22.1	77.9
Sudan	14 430	59.0	41.0
Uganda	10 956	72.9	27.1
United Republic of Tanzania	10 940 a/	13.0	85.0
Upper Volta	1 974 a/	-	100.0

Source: UNCTAD secretariat.

a/ Imputed value from decade total.

Profits of enterprises

66. Profits generated by productive units, both public and private, constitute important sources for the mobilization of domestic resources. Where State enterprises are efficient enough to generate profits and when these resources are used for creating additional productive capacities, further mobilization of domestic resources takes place. This argument extends to most economic activities, including foreign and domestic trade, in which States engage themselves. Profits from such activities are potential sources of domestic resource mobilization. Obviously, this source and method of resource mobilization has greater significance in countries that have brought industry, trade and other economic activities under public control. Among the advantages of mobilizing resources from enterprise surpluses is the fact that there is no reduction in consumption expenditure, as if, the case with compulsory savings or taxation.

67. This method of domestic resource mobilization is possible only if enterprises under public control eliminate inefficiency and wastage and maintain maximum operational efficiency. Experience in most African LDCs shows, however, that most public enterprises, instead of making profits, incur losses and have caused serious fiscal burdens; the few that earn profits do so only because they enjoy high levels of protection, a form of indirect subsidy. The poor economic and financial performance of State enterprises result, in the main, from low capacity utilization with industrial production in many African LDCs standing at less than 30 per cent of capacity, and which, in turn, results from the small size of the market, inadequate supply of raw materials and spare parts as well as deficiencies in managerial capability.

68. In order to increase resources available to Governments, public enterprises in African LDCs must be reformed and their efficiency **restored,** so that they generate rates of return that not only cover their recurrent costs, but also result in surpluses. Where managerial capabilities are poor, technical assistance may be employed effectively to eliminate deficiencies and to build up managerial capabilities; where the small size of the domestic market constrains full capacity utilization, co-operation in trade and economic matters between neighbouring African countries in general could increase the volume of effective demand.

Public borrowing

69. Internal public borrowing is among the fiscal instruments for mobilizing domestic resources. The term refers to all kinds of borrowings by Governments - from banks, business organisations and individuals, and the issue of securities, bonds and certificates which serve as additional sources of finance. Public borrowing supplements revenue from

taxes; it is also an important fiscal tool for economic stability. Household savings, corporate and other forms of savings that may not be put to any productive use because of the lack of investment opportunities and returns could be tapped by means of public borrowing.

70. Public borrowing, as a method of resource mobilization, would require the existence of a developed capital and money market to be an effective instrument. Despite this limitation, it could still be considered as yet another source of finance for capital formation. Yet very few African LDCs mention the use of public borrowing as a source of revenue to finance development programmes.

Deficit financing

71. Deficit financing, or credit and monetary expansion resulting in an increase in the supply of money, refers to a situation in which government expenditure exceeds government revenue. Deficit financing is resorted to when revenues collected from different sources are inadequate to finance expenditures, and involves one or more methods, such as borrowing or withdrawal of cash balances from central banks, the issuance of additional currency, etc.

72. Most African LDCs are rich in natural resources such as land, labour and minerals but lack the financial means to bring these resources into effective use. The use of deficit financing for the mobilization of physical resources which exist in some African LDCs but which otherwise would be unutilized or underutilized is advocated by some economists. Funds raised through deficit financing should be spent only to mobilize idle or underutilized resources, and should be used primarily for the development of infrastructure, such as power, transport, energy, water, etc.

73. Some African LDCs already show a high level of deficit financing approaching 6 per cent of their GDP. Others show modest budget surpluses. While deficit financing as a source of revenue should not be resorted to on a large scale and beyond a particular safe limit to avoid runaway inflation, it could and should be used moderately under the particular circumstances of African LDCs with budget surpluses. With effective price controls and with wages and salaries checked within reasonable limits, there certainly is a strong case for using this method of resource mobilization. However deficit financing should be considered only as a residual source of financing development expenditures and its full ramification on the economy as a whole should be examined carefully.

Mobilization of unproductive labour

74. Mobilization of the savings potential concealed in rural and urban unemployment and underemployment for productive use has long been advocated by economists as an important method of mobilizing domestic resources. According to Nurkse 9/, underemployed labour represents potential but disguised savings; its direct application with the use of simple tools could result in construction works without significant financial investments. He stressed that even large-scale investments in agriculture do not exclude the possibility of there being some immediate scope for organizational reforms that would release a certain quantity of simple tools which the workers could take with them and use.

75. The correctness of Nurkse's theory is proved by the fact that a number of developing countries have successfully used it as a guideline for development efforts. From the very beginning, China's development strategy stressed the importance of mass action by mobilizing the entire labour force for increasing production. From the point of view of capital formation, it is of decisive importance that the collective organisation of surplus labour ensures that a portion of the returns is saved and invested.

76. The collectivization drive in 1956 in China actually indicates the practical application of Nurkse's theory. The "Socialist upsurge in the Chinese countryside", a collection of descriptive and analytical essays on Chinese agricultural production co-operatives, shows that it should be possible to accumulate capital in agriculture, increase grain production and rural income through the collective organization, at the village level, of the available labour force for employment in labour-intensive agricultural and construction works. In this connection, Mao Tse-tung argued:

> "Before the organisation of agriculture, many parts of (China) had a surplus of labour; since the development of the co-operatives,, many of them are now conscious of an acute shortage of labour, so that it has become necessary to use the labour of women members fully ... agricultural productivity will be multiplied, beyond what at present can be imagined. Industrial development will be even further beyond our power to imagine; and science, culture, education, public health, etc. will have a comparable development." 10/

9/ Ragnar Nurkse, Problems of capital formation in under-developed countries, Oxford University Press, Oxford, 1953.

10/ Quoted by Jack Gray, "Mao Tse-tund's strategy for the collectivization of Chinese agriculture: An important phase in the development of Maoism", in Sociology and Development, (1974)

77. The mobilization of Chinese peasants made it possible to carry out the most labour-intensive public works of our time. It promoted not only agricultural and infrastructural development but provided, at the same time, gainful employment in the countryside. According to Balogh, the full utilization of about 25 per cent of the underutilized labour time have created the "...unprecedented capital investment of more or less one quarter of the annual national income." 11/

78. Substantial savings, both in cash and in kind, concealed in rural labour can thus be utilized to finance the recurrent and capital costs of development projects and programmes. In order to derive full advantage from these resources, communities must be convinced that development programmes are in their best interests and projects and programmes should be responsive to their needs and conditions.

79. Incentives in the form of awards of social distinction, citation, etc. are ways of eliciting enthusiasm. Such programmes, obviously, would require proper organization and leadership and the provision of the minimum necessary tools. The army and, during vacation times, students should supplement rural labour. Some African LDCs (e.g. Rwanda, Ethiopia) have already started making use of this method of resource mobilization with successful results. The method is worthy of emulation by other African LDCs.

B. Institutional infrastructure

80. The mobilization of domestic resources must obviously be accompanied by their effective utilization for development. African LDCs would, therefore, need to give special consideration to the establishment and strengthening of appropriate national institutional machineries, such as financial institutions, project planning offices and technology centres and make arrangements for regional co-operation.

1. Financial institutions

81. The mobilization of domestic resources described above requires the existence of a network of banking institutions. Institutions of primary importance in this regard, apart from central banks, are agricultural and industrial development banks and savings banks which should collect the cash surpluses of the population and fulfill the important function of financing development. It has been pointed out that the saving potential of

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11/ T. Balogh, "Agricultural and economic development". Oxford Economic Papers, vol. 13, No. 1 (Feb. 1961).

the economies of African LDCs is less than fully exploited and the development of financial institutions could help in bringing about both a higher saving rate and a better utilization of the existing flow of savings. The subsistence sector, in particular, has no other opportunity for saving than private accumulation in the form of investment in kind (houses, low quality livestock, etc.). If the subsistence sector is reached by simple financial institutions one could expect the transformation of physical capital into financial assets.

82. The propensity to save could be raised by giving individuals a broader range of opportunities for saving by offering, for example, interest rates on deposits exceeding the rate of inflation. The absence of financial institutions can only constitute a serious obstacle for the mobilization of resources; those African LDCs like Chad and the Comoros with no appropriate financial institutions to speak of would need to establish banking facilities immediately, and others would need gradually to expand banking facilities beyond what exist at present.

2. Project offices

83. The establishment and strengthening of an institutional mechanism for the identification, preparation and appraisal of development projects and programmes in African LDCs is of paramount importance for the establishment of priorities among competing projects and programmes and for the efficient allocation of resources. With scarce resources and pressing needs, it is essential that a rational and systematic approach should be used in resource allocation. A critical element in this regard is project preparation and appraisal covering the full range of financial, economic, technical and organizational conditions necessary to achieve the objectives of efficient resource allocation.

84. To ensure the efficient use of scarce resources, the use of economic prices in cost-benefit analysis would be desirable. All projects and programmes should be subjected to rigorous analysis of their costs and benefits to a given country, and such analysed should indicate financial and economic internal rates of return which are the basic criteria for project selection and appraisal. Experience shows that insufficient attention to project identification, preparation and appraisal has resulted in wrong decisions which have led to problems during the implementation and operation of projects. Problems of recurrent costs associated with on-going projects and programmes in African LDCs can essentially be linked to wrong decisions.

85. African LDCs would thus need to build up and strengthen national capabilities to conduct project studies and analysis. Technical assistance through the United Nations agencies and bilateral aid programmes could be used more effectively in institution-building for the preparation and appraisal of project and programmes.

3. National technology institutions

86. Institutional arrangements for project preparation and appraisal cannot be viewed in isolation and should be related to the establishment and strengthening of technological capabilities. The institutional mechanism in this regard could take the form of national technology centres with closer links with the African Regional Centre for Technology established jointly by the Organisation of African Unity and the Economic Commission for Africa.

87. Amongst the functions of such a centre are the provision of design and engineering services, evaluation and negotiation of contracts, selection, adaptation and unpackaging of imported technology, the provision of information about technology alternatives, together with terms and conditions of acquiring them, and formulation of policies for the transfer of technology in general.

4. Regional co-operation

88. It has been noted that the flow of resources to African LDCs will be adversely affected in the 1980s by deteriorating world economic conditions. Therefore, there is an urgent need to chart out new and more dynamic strategies for African countries in general in the direction of evolving regional programmes of co-operation. The role of co-operation among developing countries has long since been recognised in the United Nations system (TCDC, ECDC), and it occupies an important place in the Vienna Programme of Action. The Lagos Plan of Action also strongly endorses the objectives of an economically integrated and self-reliant Africa by the year 2000.

89. The favourable geographic location of African LDCs stretching, as they do, uninterruptedly from east to west across the northern half of the continent, as well as the existence of similarities and complementarities among them offer excellent opportunities for forging closer links amongst African LDCs for the exploitation of their resource potential. Parallel with the mobilization of domestic resources, therefore, African LDCs should strive towards greater collective self-reliance, and the appropriate institutions should be created and strengthened to co-ordinate regional co-operation and formulate regional development programmes and policies.

90. Finally, proposals regarding the establishment of institutions in African LDCs should be preceded by a survey of each African LDC. Such surveys should lead to objective assessments on the basis of which the institutional machinery required by each African LDC should be identified and implemented.

Table 2

Domestic Saving in African LDCs

Country	Domestic Saving (in million US dollars)			Domestic saving as percentage of gross domestic product (%)		
	1970	1975	1980	1970	1975	1980
Benin	24.0	22.4	13.2	9.5	7.6	4.42
Botswana	5.3	36.4	67.9	4.9	22.0	23.9
Burundi	8.7	7.2	9.6	3.56	2.85	2.97
Cape Verde	-*	-*	-*	-*	-*	-*
Central African Republic	23.3	7.0	9.0	11.34	3.33	4.03
Chad	11.7	13.3	12.1	3.59	3.60	3.56
Comoros	4.0	0.9	4.5	13.5	3.05	13.96
Ethiopia	187.6	218.0	292.4	9.97	10.75	12.3
Gambia	1.4	10.7	-*	2.32	14.38	-*
Guinea	44.1	105.8	137.2	6.69	14.04	15.4
Guinea Bissau	-*	-*	-*	-*	-*	-*
Lesotho	-*	-*	-*	-*	-*	-*
Malawi	49.7	53.8	114.2	13.32	10.99	18.13
Mali	45.5	9.0	41.9	13.75	2.42	8.8
Niger	9.2	20.6	46.5	2.3	5.07	7.56
Rwanda	7.6	28.9	60.3	3.36	8.56	14.0
Somalia	17.5	21.8	29.0	7.91	7.66	8.98
Sudan	212.5	341.8	192.1	9.72	13.8	6.38
Uganda	217.3	99.4	32.8	16.16	7.38	2.48
United Republic of Tanzania	232.4	134.4	384.7	18.09	8.35	19.52
Upper Volta	-*	1.8	3.9	-*	0.52	1.04

Source: ECA Statistics Division

-* Negative saving.

IV. CONCLUSIONS AND RECOMMENDATIONS

91. An attempt has been made in this paper to look at the general problems, sources and modes of domestic resource mobilization in African LDCs. While details of strategies for the mobilization of resources would need to be worked out against the background of a thorough examination of individual countries, attention could be drawn to the following preliminary conclusions and recommendations.

92. African LDCs would need to work out alternative scenarios with regard to their objectives and strategies. Priorities should be set out for the implementation of projects and programmes with emphasis being shifted to schemes resulting in higher levels of material production, while ensuring a reasonable degree of equilibrium and optimum linkages between the various sectors of the economy. At the same time, the unit costs of providing basic social services (e.g. education, health) would have to be kept as low as possible.

93. It will be necessary to embark on a programme of austerity through strict control of recurrent government expenditures, while promoting emergency financial measures immediately which would involve additional taxation and special levies on incomes and profits. The machinery for tax collection and administration should be strengthened by making use of technical assistance. The tax and tariff regime would have to be reviewed at frequent intervals to conform with economic and social conditions and objectives. Commissions on taxes and tariffs should be set up, or strengthened where they exist, to advise Governments on policies and structures in regard to taxation and tariffs, and to formulate and suggest to Governments strategy elements for resource mobilization.

94. Where enterprises are under State control, it should be the aim of government policy that they are run as profitably as possible to finance not only their operating costs but also additional investment requirements. State enterprises that have become chronically dependent on the national budget, those that do not meet the criteria of financial and economic (if dictated by desirable social objectives) efficiency and whose continued existence would be detrimental to the interests of resource mobilization, must come under critical public scrutiny. Technical assistance could be used to build up managerial capabilities in State enterprises.

95. There would seem to be an urgent need to establish, or strengthen, the appropriate institutional infrastructure at the national or regional level that will ensure, inter alia, (a) proper technico-economic feasibility studies of projects and their

appraisal as aid for an efficient allocation of resources; (b) technology institutions for the search, selection, adaptation and transfer of technologies consistent with overall social and economic development objectives; (c) tax administration and management training institutions; and (d) effective regional co-operation within the framework of the Lagos Plan of Action which should prevail over the existing state of wars, civil strife and infighting that continue to exacerbate the problem of domestic resource mobilization in African LDCs.

96. African LDCs have enormous economic resources in the form of the sun which, if properly harnessed, is an important and inexhaustible source of energy; manpower; agricultural land; water; and minerals which, if brought into full use, could result in a substantial increase in national income and domestic resources. One of the foundations on which domestic mobilization of resources must be built is knowledge of the natural resources of a country, their rational exploitation and proper husbandry. There is a very real need for studies and surveys of these resources in several African LDCs in the context of formulating policies and strategies for domestic resource mobilization.

97. The policy recommendations that are suggested in this paper for the evaluation of the resource base, the quantum of such resources as may be generated in each country as well as the institutional infrastructure for increasing domestic resource mobilization would need to be supported by appropriate missions to each African LDC.

98. It should be stressed, finally, that any increased mobilization of domestic savings would require enormous sacrifices on the part of the people of African LDCs. Sacrifices are objectively necessary as history shows, but they must be distributed evenly among the population, and the resources must be used judiciously with no room left for leakages, both internal and external, to obtain the full support of the population. And in their quest for increasing domestic savings (not including however, their continued requirements of substantial amounts of foreign aid), Governments of African LDCs should leave no stone unturned in the spirit of a Confucian saying: collect dust and thou shalt build a mountain.

AFRICAN LEAST DEVELOPING COUNTRIES - 1982

	BENIN	C.A. REPUBLIC	GAMBIA	MALAWI	SOMALIA
1	3,800,000	2,300,000	800,000	6,200,000	4,600,000
2	6.5	—	6.0	3.1	3.5
3	1758	971	598	—	1989
4	82.0	100	91.2	—	77.9
5	18.0	—	4.8	—	22.1

	BOTSWANA	CHAD	GUINEA	MALI	SUDAN
1	800,000	4,800,000	5,000,000	6,900,000	18,400,000
2	10.1	—	5.1	—	6.0
3	1928	—	1639	2740	14,430
4	15.4	—	42.1	97.4	41.0
5	66.6	—	57.9	2.6	59.0

	BURUNDI	COMOROS	G. BISSAU	NIGER	UGANDA
1	4,200,000	400,000	800,000	5,300,000	13,200,000
2	4.4	—	—	4.3	3.4
3	1194	240	—	2792	10,856
4	82.9	100	—	57.0	27.1
5	17.1	—	—	43.0	72.9

	CAPE VERDE	ETHIOPIA	LESOTHO	RWANDA	TANZANIA
1	300,000	31,500,000	1,300,000	4,800,000	17,900,000
2	7.8	7.5	—	5.0	4.1
3	397	7000	—	1877	10,940
4	86.5	52.9	—	90.9	85.0
5	13.1	47.1	—	9.1	15.0

	UPPER VOLTA
1	6,900,000
2	—
3	1784
4	100
5	—

1 [800,000] POPULATION (1980)

2 [10.1] GDP GROWTH RATES (1981-86)

3 [1928] TOTAL DEVELOPMENT EXP. (US$. 1981-86)

4 [15.4] EXTERNAL AID REQUIRED (%)

5 [86.6] DOMESTIC FINANCING (%)